

Power Brokers

Across the country, states are encouraging government-regulated utilities to swallow a healthy dose of competition. The result is cheaper electricity for some. But critics say there's a downside to the free market for electricity. Other experts say the federal government should set the ground rules.

BY MARGARET KRIZ

NEW BEDFORD, MASS.—In late October, the Sgt. Carney Academy elementary school auditorium was festooned with paper pumpkins and 10-foot-tall scarecrows when the Massachusetts Public Utilities Department held its hearing there on proposals to dismantle electric utility monopolies in the state.

Given that the city has some of the highest electricity rates in the state, New Bedford, located 40 miles south of Boston, was a logical place to drum up support for proposals that would allow other companies to compete with the utilities to sell electricity. State officials and utility executives promise that the new competition will result in cheaper electricity for Massachusetts customers.

As proof that competition will cut electricity costs, state Attorney General Scott Harshbarger in September unveiled an agreement under which Massachusetts Electric Co. would guarantee a 10 per cent rate cut to its one million customers. The deal, which is part of a broader proposal to begin electricity competition in the company's service area, is now being reviewed by the state regulatory agency. Harshbarger's staff is also negotiating with the state's seven other electric monopolies in hopes of reaching similar agreements.

Local industry and the Conservation Law Foundation, a Boston-

based public-interest law firm that helped in the negotiations, cheered the Massachusetts Electric deal. But speakers at the New Bedford hearing were wary of the state's vision for changing the character of the electric industry. Many objected to provisions in the deal that would force all electricity customers to pay for the utilities' expensive projects, such as their investments in nuclear power plants. Some residents recalled fighting to stop construction of the same nuclear facilities they would now be compelled to bail out.



John W. Rowe, president of New England Electric Systems
State officials want competition and price reductions.

"We think asking electric customers to pay the utility shareholders for the company's mistakes is an absolute outrage," Irwin Marks, a resident of nearby Lynn, said at the hearing.

Others worried that the reliability of electric service could be threatened as electricity providers fight for profits. "This industry has always operated under the assumption that you err on the side of surplus electric capacity," said Edward Collins of Springfield, who represents the Massachusetts Alliance of Utility Unions, a coalition of three state utility groups. "The new companies will have no duty to serve their customers, only to make a profit. And you can make a profit out of scarcity as well as abundance."

State Sen. Mark C. Montigny, a Democrat who represents the Now Bedford area, worried that state regulators may rush to approve Harshbarger's proposal before either the public or the legislature has time to evaluate the plan. "I'm deeply troubled if this is the final settlement," he said. "I'm very excited if this is the beginning of negotiations."

So far, the deal amounts to a "merry Christmas to the utility stockholders and happy Halloween to the customers and workers of the electric utilities," Montigny said at the hearing.

OTHER STATE EFFORTS

Harshbarger's proposal follows a trail blazed by California and Rhode Island, which adopted statewide utility restructuring plans earlier this year. The Pennsylvania legislature is also poised to enact an electric utility deregulation bill. New Hampshire, with the nation's highest electricity rates, has tested competition through a series of community pilot programs. State regulators are considering adopting electricity competition by 1998. Dozens of other states are reviewing proposals to inject a dose of competition into their electric monopoly systems. Not surprisingly, the states first out of the box are those with the most-expensive electricity. (For more on utility rates, see box, p. 2599.)

But some states that have cheaper supplies of power and don't want to share them with less fortunate states are dragging their feet to delay competition. Utilities still paying for high-cost construction projects are also reluctant to enter a competitive marketplace.

Energy experts agree, however, that the industry is well on the way toward a competitive revolution. In the electricity supermarket of the future, utilities will be responsible for the local electric distribution system, which is essentially the highway that carries power into each home and business. But consumers will be able

to buy electricity from any of the many power generating firms that are springing up around the country.

The impetus for utility restructuring began in 1992, when Congress passed the Energy Policy Act, which required all utilities to share their transmission lines with other utilities. As a result, a utility in New York state can buy low-cost electricity from North Carolina by shipping it—for a price—over the electrical lines owned by the utilities in between.

Meanwhile, energy-intensive manufacturers around the country began looking for a way to access cheaper power. In Massachusetts, for example, the Raytheon Co., one of the state's largest employers, threatened to move elsewhere if its utility didn't reduce the company's rates. Raytheon got its price cut.

Responding to corporate pressure, a handful of states began considering legislative changes to permit their large manufacturers to buy cheaper out-of-state electricity. Lawmakers in other states would prefer to let all customers choose their electric suppliers.

"More and more states are going to electricity competition because they're competing among themselves for a bigger share of the economic pie, which low-cost power can stimulate," said John P. Hughes, technical affairs director of the Electricity Consumers Resource Council, which represents large industrial electricity users.

Retail competition has also been spurred on by electricity marketers—companies acting as brokers to expedite interstate electricity sales. In 1992, only eight power marketing firms existed; today 250 marketers are vying for business, according to David K. Owens, senior vice president for finance, regulation and power supply policy at the Edison Electric Institute (EEI), the Washington trade association for privately owned utilities.

The emergence of power marketing



Massachusetts EPA commissioner David B. Strick
The state's energy deal may not benefit the environment.

companies is only one example of the ongoing metamorphosis of the electricity industry. As companies try to grab a piece of the \$200-billion-a-year market, mergers, new partnerships and even bankruptcies are transforming the industry.

Although many manufacturers are already enjoying the fruits of increased competition, most small businesses and residential customers are not. In July, Rep. Daniel Schaefer, R-Colo., chairman of the Commerce Subcommittee on Energy and Power, sought to even the playing field with a bill that would have required the states to offer electricity competition to all customers by Dec. 15, 2000. (See NJ, 8/3/96, p. 1631.)

Schaefer's bill died. But it raised the profile of electric utility restructuring on the federal level. House Commerce Committee chairman Thomas J. Bliley Jr., R-Va., has declared federal electricity legislation to be one of his panel's top priorities in the 105th Congress. Moreover, the Clinton Administration is drafting its own electricity restructuring bill. (For excerpts from an interview with deputy

THE STATES HAVE STARTED THE BALL ROLLING...

Deputy Energy secretary Charles B. Curtis is in charge of the Clinton Administration's efforts to guide the electric utility industry toward free-market competition. Curtis, a veteran energy lawyer and the former chairman of the Federal Energy Regulatory Commission, has also been mentioned as a candidate to replace Energy Secretary Hazel R. O'Leary, who has announced her retirement. In a Nov. 14 interview, Curtis explained the Administration's position on electric utility restructuring.

Q: How quickly do you see electric utility restructuring occurring?

A: Everyone who has had some experience in this industry is somewhat stunned by the pace of change that is under way. What we are seeing reflected is that the pace of change is demanding some public expression in Congress. I think there is general agreement that the federal regulatory and policy framework for this industry has to be changed. That framework largely derives from laws that were written in the '30s. They have at their foundations quite different understandings about technology and the role and relationships of the states and federal regulatory apparatus. There is a recognition that this framework does not accommodate the changes that are made possible both by technology and by a perception of the benefits that would occur as a result of

restructuring and intensifying the competitive opportunities of the industry.

Q: Several states have already adopted plans to introduce competition for their



Deputy Energy secretary Charles B. Curtis
"Electrons don't respect borders."

electricity customers. Does that preclude the federal government from acting on this issue?

A: If direct-choice markets are to evolve effectively... California, Rhode Island

and New Hampshire are adopting policies that favor retail choice—you need to change the [1935] Public Utility Holding Company Act to permit the ownership and operation of generation and associated transmission facilities to provide retail service. The Holding Company Act is an absolute bar to it. You also have to remove the possible preemptive effects of the [1935] Federal Power Act that might preclude states from putting into effect the policies that they have enacted. What California did in very significant measure implicated interstate commerce, and whether the California plan can be carried out remains to be seen. It first requires permission from the Federal Energy Regulatory Commission. And some of the things that the state legislatures are addressing are clearly matters committed to federal authority under existing law.

Q: There certainly is a tug of war going on between the state and federal government authorities.

A: One of the very important questions for the Congress to sort out is what are the appropriate boundaries of federal and state authority. The reality is that our

electricity markets do not behave according to political boundaries. Electrons don't respect borders. These markets are organized and operating as regional markets in a number of areas.

Energy secretary Charles B. Curtis, see box, this page and next.)

Unlike telecommunications deregulation, which took more than a decade to accomplish, "I don't think we're looking at 10 years," EFP's Owens said. "I think we're looking at significant changes over the next two to four years."

GO WITH THE FLOW

John W. Rowe, president and chief executive officer of Westborough (Mass.)-based New England Electric Systems (NEES), has a theory about change. "You have two choices," Rowe said in a recent interview. "You can say bad things are going to happen and I'm just going to grind them out and delay them as long as I can. Or you can say bad things are going to happen, but maybe they'll hurt me a

lot less if I get out in front and try to shape them."

It's a doctrine that Rowe employed in 1995, when Rhode Island lawmakers approved legislation that would have allowed state industrial parks to buy electricity from cheap power generators outside the state. That measure was a call to arms to Narragansett Electric Co., an NEES subsidiary that supplies power to 80 per cent of Rhode Island. The utility opposed the measure not only because it would have cut into its business, but also because the bill wouldn't allow it to recover billions of dollars in unpaid costs, known in the industry as stranded investments.

Gov. Lincoln C. Almond vetoed the bill, but not before Rowe pledged to work with the measure's chief author, House Majority Leader George D. Caruolo, to

craft a compromise package. They came up with a plan to phase in competition beginning in July 1997. The package also establishes a charge of 2.8 cents per kilowatt hour imposed on all Rhode Island consumers, even those choosing to buy electricity from another company. The money will be used to underwrite the utilities' stranded costs. The compromise became law in August.

Rhode Island officials "wanted competition, they wanted price reductions," Rowe said. "But they also wanted to keep a solvent utility around to pick up the pieces if this new experiment gets screwed up."

Rhode Island's plan will serve as a template for electric utility restructuring throughout New England, particularly in Massachusetts. Rowe contends. In fact, Rowe helped mold the September utility-

... BUT THE FEDS ARE GETTING READY TO PLAY

So even state regulation cannot well comprehend and be effective in those markets. Something needs to be worked out that would permit a better balance of relationship between state authority and federal authority.

Q: Rep. John D. Dingell, D-Mich., has said before with regard to electricity restructuring, "If it ain't broke, don't fix it." Why are we seeing so much activity on restructuring now?

A: It is clear that electricity generation is no longer a natural monopoly, and competition is not only possible but it has proved to be beneficial. The experience under the Energy Policy Act of 1992 demonstrates that there are genuine large efficiencies that can be achieved in the electricity markets and very large consumer benefits that can be harvested by increasing the competitiveness of these markets.

Q: What's the status of the Administration's effort?

A: The electric utility restructuring issue is, in my judgment, the No. 1 energy policy issue. In terms of its economic impact, it is probably the No. 1 domestic economic policy issue, aside from the budget. It is imperative that the executive branch make recommendations to the Congress as to how this matter might best be disposed. I think there is general recognition that this is an issue that will be taken up in the very early days of the 105th Congress. [House Commerce Committee chairman] Tom Bliley [R-Va.] and [Energy and Power

Subcommittee chairman] Dan Schaefer [R-Colo.] both made very clear that this is a priority matter. So the Administration will be keyed to be able to present recommendations to the Congress at the beginning of this next Congress. Most

"I think it's clear that the Congress can legislate all the way to the socket in the wall if it wishes to."

likely, in my judgment, it will take the form of a legislative proposal.

Q: The restructuring legislation that Rep. Schaefer introduced in July takes a bare-bones approach, directing states to open their utility industries to competition on a certain date, but allowing the states to fill in the details of the plan. Is this the approach the Administration is taking?

A: Whether there is going to be a federal

mandate that states must adopt customer choice by a certain date is ... probably the seminal question in the debate. The Administration will have to address that. My preliminary position has been that we should remove the barriers to state choice, but we should not compel state choice. As a constitutional matter, I think it's clear that the Congress can legislate all the way to the socket in the wall if it wishes to. ... But it would be an extraordinary exercise of federal power to preempt states' judgments about how electrical service should be provided to customers at the retail level. It has been among the most important of state policy powers exercised over the years.

Q: Some citizens' groups fear that giving the states broad leeway could result in a "race to the bottom" as states eliminate consumer protections to encourage companies to lower their electricity rates. That could end up with one state retaining its low-income assistance programs, for instance, and another state dropping those programs.

A: In the states that have acted so far, I don't think there is a demonstrable record to support that position. They've dealt with these issues in ways that should allay those concerns. But I believe it is a responsibility better exercised at the state level to work out the balances between consumer equity and the quality and the nature of the service that they're going to insist on for their customers. I'm much more trusting of how the states will make these judgments.

restructuring deal between the attorney general's office and Massachusetts Electric, which is also owned by NEES.

That deal includes a tempting tradeoff: Massachusetts Electric customers would get guaranteed cheaper electricity by 1998 and the company's stranded investments would be repaid. Massachusetts Electric serves a third of the state. If a similar deal is accepted by the state's other utilities, consumers could save more than \$3 billion over seven years, according to assistant attorney general George B. Dean, chief of the regulated industries division.

The utility's proposal would allow customers to select their electricity supplier from a swarm of companies expected to descend on the state to sell electricity. Or consumers could accept a standard offer from Massachusetts Electric that would

guarantee them a 10 per cent cut in their electricity bill. The quid pro quo is that all electricity consumers in Massachusetts Electric's service region would be required to pay an access charge of 1.9 cents per kilowatt hour to underwrite the utility's investments that had been approved by the state utility commission. The access charge would be imposed even if customers began buying electricity from another power company.

As part of the accord, company officials agreed to continue current financial assistance programs for low-income residents and for developing alternative energy sources.

Some environmentalists are enthusiastic about the deal. Massachusetts Electric has promised to upgrade the air pollution controls on fossil-fueled power plants that have been operating for more than

40 years. The utility's accord with the state is the first step in building a competitive electricity market in which existing tax subsidies will be lifted and all power generating plants will meet national air pollution standards, said Lewis Milford, head of the energy program at the Conservation Law Foundation. "Why should we protect the status quo electricity market?" Milford asked. "The challenge is to turn over the existing dirty fleet of utilities to something safer. Restructuring is really the only avenue to make that happen."

But David B. Struhs, the state's Environmental Protection Department commissioner, criticized the environmental provisions of the attorney general's deal with Massachusetts Electric. In comments to the Public Utilities Department, he asserted that the deal offers ambigu-



Southern California Edison lobbyist Thomas J. Demais
States without competition shouldn't get to buy cheap power.

from the Massachusetts Electric settlement, but all of them will include a guarantee that electric prices drop by at least 10 percent. "They have different mixes of resources and problems," he said. "We kept telling them, 'It's a size 10 suit, but we can do some tailoring.'"

For some utilities, it could be a tight squeeze. Those companies may consider using a new financial tool developed by the California legislature. In the Golden State, lawmakers agreed to sell low-interest bonds that will underwrite the utilities' stranded costs and will result in immediate electricity price cuts for all customers. The bonds will be repaid through a, electricity access charge imposed on all state electricity customers.

"Up and down the East Coast, state legislatures are looking at securitization as a way to drive down the

transition costs to competition," Boston Edison president and chief executive officer Thomas J. May said. "Stranded costs is the linchpin in every single deal that is being worked out." His firm is likely to finalize its deal with the attorney general's office before the end of the year, May said.

All utility restructuring proposals must be approved by the Massachusetts Public Utilities Department. But the state legislature is also interested in the utilities plans. Still, Rowe is confident that state lawmakers will eventually embrace the utility's proposal. "I don't think the legislature would choose to stand in the way of all the benefits this will provide to Massachusetts," Rowe said.

Dean doesn't think legislation is needed to implement the Massachusetts Electric restructuring package. But Massachusetts state Sen. John D. O'Brien, who co-chairs a joint House-Senate panel on electricity restructuring, disagrees. Dean and O'Brien agree that in the long term, lawmakers need to modernize the state's utility department by eliminating such relics of the monopoly era as the

state energy facility siting board, which approves the construction of power plants.

But O'Brien is open to more fundamental changes in state law. "The NEES deal moves the process forward," he said. "But you want to do this correctly. The danger is that all these groups bring this settlement up here and say, 'Would you please rubber-stamp this.' The, there is a huge rush to do it."

Utility company officials say their customers are clamoring for faster action in Massachusetts. "If Massachusetts is going to get competition by January 1998, we don't have a lot of lead time," Boston Edison's May said. "We want to start grabbing our market share, just like everybody else wants to."

CALIFORNIA DREAMING

In August, just as California lawmakers were debating legislation to allow competing companies to sell electricity, the capitol building and much of the rest of the region went black, hit by a massive power outage. When the power came back on, legislators beefed up their bill to avert future electrical outages.

California lawmakers have the power to control the integrity of the state's power grid. The new state law created a regulatory body, called the Independent Systems Operator, which has the authority to monitor the power shipped through the state electricity grid. The law also established an electricity price exchange, which will set power rates based on the latest market prices.

But California can go only so far on its own. Electricity doesn't respect political boundaries. "You can't define the grid as ending at state borders," said Karen L. Palmer, a fellow at Resources for the Future Inc. and co-author of *A Shock to the System: Restructuring America's Electricity Industry*. "There are going to have to be at least regional entities governing the pricing, access and sharing of the transmission lines."

Because its electricity grid is intricately intertwined with those of other western states, California's system will eventually become a western regional network, Pacific Gas & Electric Co. rate manager Tom Bortorff said. "There will come a time when other states are likely to join the power exchange and the independent power operator system," he said. "This will not always be a state-by-state issue," Bortorff added.

New multistate regulatory bodies may have to be created, either through Congress or through the Federal Energy Regulatory Commission, to establish the ground rules for such a system.

Nonetheless, states are likely to main-

ous promises of pollution reductions that will be achieved only if utilities in the Midwest cut their emissions. "If those significant events do not occur, no environmental progress will be made," Struhs said.

Other opponents of the plan contend that it contains some significant small prior. For example, the 10 percent savings is guaranteed only for seven years, and the savings would shrink if fuel prices go up by more than 25 percent.

The private negotiations that led to Rowe's restructuring plan have been criticized by some groups. "This was close to being a secret rule making," Rub Sargent, legislative director for the Massachusetts Public Interest Research Group, complained. "They're treating the revamping of the entire electricity industry as if it were a routine rate case. We're frustrated because we were told that this was going to be a public process," he added, "but every time we suggest any changes, they tell us, 'Can't do it. It's not in the settlement.'"

Dean said that the deals he's negotiating with other utilities may be different

tain control over some of the industry's most difficult problems in evolving to an open marketplace. Utility officials argue that state regulators are best equipped to determine which stranded costs should be repaid by consumers and which should be absorbed by company stockholders. So far the states have been very generous to their utilities: Both California and Rhode Island gave their utilities the opportunity to recover the entire cost of past investments.

The states may also be in the best position to ensure that utility companies continue to offer such social programs as price reductions for low-income families and electric service to all customers, although some consumer groups are calling for federal standards to make sure all consumers are treated fairly. Municipal officials also are turning to the states to solve local tax problems. For example, cities might lose millions in tax revenues if their utilities, which now pay local property taxes on their equipment as well as their land, sell their power plants to nonutility firms that are not taxed on their equipment.

LET THE FEDS DO IT

Other issues are beyond the states' control and demand a federal solution. Reciprocity, for example, is a big worry in California, where utilities will get the right to sell electricity on the competitive market beginning in 1996. "Are we to be put in the position in which people from out of state can come in and sell in our markets while we can't sell in theirs?" asked Thomas J. Dennis, a Southern California Edison vice president and lobbyist in Washington. Dennis would prefer a system of reciprocity under which companies located in states that allowed other companies to sell electricity in their jurisdiction could sell electricity outside that state, but firms in states that didn't allow competition would be limited to in-state transactions.

Federal action is also backed by companies that want to repeal the 1935 Public Utility Holding Company Act, which established special rules for companies operating in more than one state, and the 1978 Public Utility Regulatory Policies Act, which required utilities to buy electricity from alternative energy sources.

Only Congress can tackle the politically charged issue of whether municipal power companies and federal power marketing administrations, which enjoy special tax advantages, should be permitted to compete in an open electricity market. "They shouldn't be allowed to expand their competition using the advantages that they have," EEL's Owens said. Law-

ELECTRICITY COSTS BY STATE

(electricity rates, in cents per kilowatt hour, as of July 1996)

STATES WITH THE 10 HIGHEST RATES				
	TOTAL RATE	RESIDENTIAL	COMMERCIAL	INDUSTRIAL
New Hampshire	11.7¢	13.5¢	11.3¢	9.3¢
New York	11.1	14.0	11.9	5.3
Rhode Island	10.6	12.1	10.2	8.6
Connecticut	10.5	12.0	10.3	7.8
New Jersey	10.5	11.9	10.3	8.2
Massachusetts	10.1	11.2	9.9	8.4
Vermont	9.8	11.8	10.1	7.7
Maine	9.7	12.6	10.7	6.7
California	9.1	11.2	9.4	6.8
Pennsylvania	7.9	9.6	8.3	5.9

STATES WITH THE 10 LOWEST RATES				
	TOTAL RATE	RESIDENTIAL	COMMERCIAL	INDUSTRIAL
Idaho	4.0¢	5.3¢	4.3¢	2.7¢
Kentucky	4.1	5.6	5.3	2.9
Washington	4.2	5.1	4.9	2.9
Wyoming	4.2	6.0	5.0	3.4
Oregon	4.8	5.7	5.1	3.4
Montana	5.0	6.2	5.4	3.6
Indiana	5.2	6.8	6.0	3.9
Tennessee	5.2	5.9	6.2	4.3
Nebraska	5.2	6.2	5.5	3.8
West Virginia	5.3	6.4	5.8	4.0

SOURCE: Energy Department's Energy Information Administration (Alaska and Hawaii excluded)

makers from regions served by the public utilities, however, have consistently fought efforts to privatize or limit the growth of those companies.

Restructuring is likely to cause a historic reshuffling of authority between the federal government and state regulators, who have traditionally had primary authority over the electric utility industry. As the electricity industry becomes more national and international, the federal government is taking on more responsibility.

And many states and utility industry officials don't like it. They argue that the federal government should do only the bare minimum in removing the barriers to new competition. "It would be very bad for us to see Congress do a one-size-fits-all piece of legislation," NEES's Rowe said. "I think our states are doing a pretty good job of handling it at this point, and I'm more fearful that Washington will muck it up than hopeful that Washington will fix it."

If federal legislation is passed, however, some utility company officials want national lawmakers to grandfather any state plans that have already been enacted.

But as the 105th Congress approaches, the momentum has increased for federal restructuring legislation. "There's been an acceleration of effort," said Steve Kean, vice president of Enron Capital and Trade, a subsidiary of Houston-based Enron Corp. "One reason is the money to be saved in the electric industry is huge. You could have a huge impact on the economy. The second thing is, we've done this so many times in this country now that we know how to deregulate an industry," he said, noting that the Congress that deregulated the telecommunications industry this year will be willing to tackle the electric monopolies next year.

Dennis of Southern California Edison said that Congress is unlikely to do a hare-banes piece of legislation. If lawmakers decide to tackle electric utility restructuring, they'll be pressured to address all the competing state, business, environmental and consumer issues, unleashing a battle royal.

"I'm a firm believer that the Congress is only going to do this once, like they did with the telecommunications bill," Dennis said. "They're not going to come back and do little pieces."